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Sun Microsystems from April 1994 to April 1999. George is also a director of BEA Systems, an application infrastructure software company, and Symantec, an information security company. George holds a Masters of Business Administration degree from Santa Clara University and a Bachelor of Arts degree in accounting from the University of South Florida.

Jonathan J. Rosenberg has served as our Vice President of Product Management since February 2002. Prior to joining us, from October 2001 to February 2002, Jonathan served as Vice President of Software of palmOne, a provider of handheld computer and communications solutions. From November 2000 until October 2001, Jonathan was not formally employed. From March 1996 to November 2000, Jonathan held various executive positions at Excite@Home, an Internet media company, most recently as its Senior Vice President of Online Products and Services. Jonathan holds a Masters of Business Administration degree from the University of Chicago and a Bachelor of Arts degree with honors in economics from Claremont McKenna College.

Shona L. Brown has served as our Vice President of Business Operations since September 2003. Prior to joining us, from October 1995 to August 2003, Shona was at McKinsey & Company, a management consulting firm where she had been a partner since December 2000. Shona holds a Ph.D. and Post-Doctorate in industrial engineering and engineering management from Stanford University, a Masters of Arts degree from Oxford University (as a Rhodes Scholar), and a Bachelor of Science degree in computer systems engineering from Carleton University.

ITEM 2. PROPERTIES

We lease approximately 915,000 square feet of space in our headquarters in Mountain View, California. We also lease additional research and development, sales and support offices in Amsterdam, Atlanta, Bangalore, Boston, Chicago, Dallas, Denver, Detroit, Dublin, Duesseldorf, Frankfurt, Hamburg, Hong Kong, Hyderabad, Irvine, Kirkland, London, Los Angeles, Madrid, Milan, Montreal, Mountain View, Munich, New York, Paris, Rome, Santa Monica, Seattle, Seoul, Shanghai, Stockholm, Sydney, Tokyo, Toronto and Zurich. We operate data centers in the United States and the European Union pursuant to various lease agreements and co-location arrangements.

ITEM 3. LEGAL PROCEEDINGS

Certain companies have filed trademark infringement and related claims against us over the display of ads in response to user queries that include trademark terms. The outcomes of these lawsuits have differed from jurisdiction to jurisdiction. Courts in France have held us liable for allowing advertisers to select certain trademarked terms as keywords. We are appealing those decisions. We were also subject to two lawsuits in Germany on similar matters where the courts held that we are not liable for the actions of our advertisers prior to notification of trademark rights. We are litigating or recently have litigated similar issues in other cases in the U.S., France, Germany and Italy. Adverse results in these lawsuits may result in, or even compel, a change in this practice which could result in a loss of revenue for us, which could harm our business.

From time to time, we may also become a party to other litigation and subject to claims incident to the ordinary course of business, including intellectual property claims (in addition to the trademark matters noted above), labor and employment claims, breach of contract claims, and other matters.

Although the results of litigation and claims cannot be predicted with certainty, we believe that the final outcome of the matters discussed above will not have a material adverse effect on our business. Regardless of the outcome, litigation can have an adverse impact on us because of defense costs, diversion of management resources and other factors.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of our security holders during the fourth quarter of fiscal 2004.

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PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our Class A common stock has been quoted on The Nasdaq National Market under the symbol "GOOG" since August 19, 2004. Prior to that time, there was no public market for our stock. As of March 28, 2005, there were approximately 2,155 stockholders of record, and the closing price of our common stock was $181.42 per share as reported by The Nasdaq National Market.

The following table sets forth for the indicated periods the high and low sales prices for our Class A common stock on The Nasdaq National Market.

Fiscal Year 2004 Quarters Ended:	High	Low
September 30, 2004	$135.02	$ 95.96
December 31, 2004	201.60	128.90

Our Class B common stock is neither listed nor publicly traded.

Dividend Policy

We have never declared or paid any cash dividend on our common stock. We currently intend to retain any future earnings and do not expect to pay any dividends in the foreseeable future.

Unregistered Sales of Equity Securities

The following sets forth information regarding unregistered securities sold by us in 2004.

1. In 2004, we issued an aggregate of 263,249 shares of common stock with an aggregate value of $31,450,549 in connection with various mergers and acquisitions during this period. These issuances are described more fully below.

- In April 2004, we issued 20,867 shares of common stock, which includes 2,141 shares issuable upon exercise of options, with an aggregate value of $1,965,987 to the former shareholders of a privately-held technology corporation in connection with our acquisition of such corporation.
- In July 2004, we issued 75,985 shares of common stock, which includes 16,018 shares issuable upon exercise of options, with an aggregate value of $6,290,389 to the former shareholders of a privately-held technology corporation in connection with our acquisition of such corporation.
- In October 2004, we issued 43,400 shares of common stock, with an aggregate value of $5,753,972 to the former shareholders of a privately-held technology corporation in connection with our acquisition of such corporation.
- In October 2004, we issued 122,997 shares of common stock, which includes 31,129 shares issuable upon exercise of options and 355 shares issuable upon exercise of a warrant, with an aggregate value of $17,440,201 to the former shareholders of a privately-held technology corporation in connection with our acquisition of such corporation.

2. In 2004, we issued to our directors, officers, employees and consultants options to purchase 3,067,840 shares of common stock with an aggregate exercise price of $142,034,260 and have issued 260,998 shares of common stock for an aggregate purchase price of $4,812,855 upon exercise of such options.

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3. In 2004, we issued shares of our capital stock to the following investors:

- In May 2004, we issued to an accredited investor upon exercise of a warrant 7,437,452 shares of Series D Preferred Stock (converted to Class B common stock) for an aggregate purchase price of $21,642,985.
- In May 2004, we issued to an accredited investor upon exercise of a warrant 100,000 shares of Class B Common Stock for an aggregate purchase price of $234,250.
- In August 2004, we issued to an accredited investor 2,700,000 shares of Class A common stock for an aggregate purchase price of $229,500,000 based on an assumed price of $85.00 per share in connection with a settlement arrangement.

Except as noted below, the issuance of securities described above were deemed to be exempt from registration under the Securities Act of 1933 in reliance on Section 4(2) of the Securities Act of 1933 as transactions by an issuer not involving any public offering. The recipients of securities in each such transaction represented their intention to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof and appropriate legends were affixed to the share certificates and other instruments issued in such transactions. The sales of these securities were made without general solicitation or advertising.

The option grants and stock issuances described in paragraph 2 above include the issuance of 2,318,570 options and 255,046 shares of our common stock that may not have been exempt from registration or qualification requirements under federal or state securities laws. Consequently, certain of the options we granted and the shares issued upon exercise of these options may have been issued in violation of federal or state securities laws, or both, and may be subject to rescission. On November 30, 2004, we made a rescission offer to all holders of any outstanding options and shares that we believe are subject to rescission, pursuant to which we offered to repurchase these options and shares then outstanding from the holder. At the expiration of our rescission offer on December 30, 2004, none of the holders of such options and shares subject to rescission had accepted our rescission offer.

Use of Proceeds

On August 18, 2004, a registration statement (Registration No. 333 114984) relating to our initial public offering of our Class A common stock was declared effective by the Securities and Exchange Commission. Under this registration statement, we registered 19,605,052 shares of our Class A common stock, and another 2,929,626 shares subject to the underwriters' over-allotment option. All 22,534,678 shares of Class A common stock registered under the registration statement, including the 2,929,626 shares covered by the over-allotment option, were sold at a price to the public of $85.00 per share. 14,142,135 shares were sold by us and 8,392,543 shares, including the 2,929,626 shares covered by the over-allotment option, were sold by the selling stockholders identified in the registration statement. The offering closed on August 24, 2004. The managing underwriters were Morgan Stanley, Credit Suisse First Boston, Goldman, Sachs & Co., Citigroup, Lehman Brothers, Allen & Company LLC, JPMorgan, UBS Investment Bank, WR Hambrecht+Co and Thomas Weisel Partners LLC.

The offering did not terminate until after the sale of all of the shares registered on the registration statement. The aggregate gross proceeds from the shares of Class A common stock sold by us were $1,202.1 million. The aggregate net proceeds to us from the offering were approximately $1,161.1 million, after deducting an aggregate of $33.7 million in underwriting discounts and commissions paid to the underwriters and an estimated $7.3 million in other expenses incurred in connection with the offering. We invested the net proceeds in investment-grade, interest bearing instruments, pending their use to fund working capital and capital expenditures.

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ITEM 6. SELECTED FINANCIAL DATA

You should read the following selected consolidated financial data in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the related notes appearing elsewhere in this Form 10-K.

The consolidated statements of operations data for the years ended December 31, 2002, 2003 and 2004, and the consolidated balance sheet data at December 31, 2003 and 2004, are derived from our audited consolidated financial statements appearing elsewhere in this Form 10-K. The consolidated statements of operations data for the years ended December 31, 2000 and December 31, 2001, and the consolidated balance sheet data at December 31, 2000, 2001 and 2002, are derived from our audited consolidated financial statements that are not included in this Form 10-K. The historical results are not necessarily indicative of the results to be expected in any future period.

	Fiscal Year Ended December 31,				
	2000	2001	2002	2003	2004
	(in thousands, except per share data)				
Consolidated Statements of Operations Data:					
Revenues	$ 19,108	$ 86,426	$439,508	$1,465,934	$3,189,223
Costs and expenses:					
Cost of revenues	6,081	14,228	131,510	625,854	1,457,653
Research and development	10,516	16,500	31,748	91,228	225,632
Sales and marketing	10,385	20,076	43,849	120,328	246,300
General and administrative	4,357	12,275	24,300	56,699	139,700
Stock-based compensation(1)	2,506	12,383	21,635	229,361	278,746
Non-recurring portion of settlement of disputes with Yahoo	—	—	—	—	201,000
Total costs and expenses	33,845	75,462	253,042	1,123,470	2,549,031
Income (loss) from operations	(14,737)	10,964	186,466	342,464	640,192
Interest income (expense) and other, net	47	(896)	(1,551)	4,190	10,042
Income (loss) before income taxes	(14,690)	10,068	184,915	346,654	650,234
Provision for income taxes	—	3,083	85,259	241,006	251,115
Net income (loss)	$(14,690)	$ 6,985	$ 99,656	$ 105,648	$ 399,119
Net income (loss) per share(2)					
Basic	$ (0.22)	$ 0.07	$ 0.86	$ 0.77	$ 2.07
Diluted	$ (0.22)	$ 0.04	$ 0.45	$ 0.41	$ 1.46
Number of shares used in per share calculation(2)					
Basic	67,032	94,523	115,242	137,697	193,176
Diluted	67,032	186,776	220,633	256,638	272,781

(1) Stock-based compensation, consisting of amortization of deferred stock-based compensation and the value of options issued to non-employees for services rendered, is allocated as follows:

	Fiscal Years Ended December 31,				
	2000	2001	2002	2003	2004
	(in thousands)				
Cost of revenues	$ 167	$ 876	$ 1,065	$ 8,557	$ 11,314
Research and development	1,573	4,440	8,746	138,377	169,532
Sales and marketing	514	1,667	4,934	44,607	49,449
General and administrative	252	5,400	6,890	37,820	48,451
	$2,506	$12,383	$21,635	$229,361	$278,746

(2) See Note 1 of Notes to Consolidated Financial Statements included in this Form 10-K for information regarding the computation of per share amounts.

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	Fiscal Years Ended December 31,				
	2000	2001	2002	2003	2004
			(in thousands)		
Consolidated balance sheet data:					
Cash, cash equivalents and marketable securities	$19,101	$ 33,589	$146,331	$ 334,718	$2,132,297
Total assets	46,872	84,457	286,892	871,458	3,313,351
Total long-term liabilities	7,397	8,044	9,560	33,365	43,927
Redeemable convertible preferred stock warrant	—	—	13,871	13,871	—
Deferred stock-based compensation	(8,457)	(15,833)	(35,401)	(369,668)	(249,470)
Total stockholders' equity	27,234	50,152	173,953	588,770	2,929,056

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of the financial condition and results of our operations should be read in conjunction with the consolidated financial statements and the notes to those statements included elsewhere in this Form 10-K. This discussion contains forward-looking statements that involve risks and uncertainties. Google's actual results could differ materially from those discussed below. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled "Factors That Could Affect Future Results" starting on page 45 of this Form 10-K.

Overview

Google is a global technology leader focused on improving the ways people connect with information. Our innovations in web search and advertising have made our web site a top Internet destination and our brand one of the most recognized in the world. Our mission is to organize the world's information and make it universally accessible and useful. We serve three primary constituencies:

- *Users*. We provide users with products and services that enable people to more quickly and easily find, create and organize information that is useful to them.
- *Advertisers*. We provide advertisers our Google AdWords program, an auction-based advertising program that enables them to deliver relevant ads targeted to search results or web content. Our AdWords program provides advertisers with a cost-effective way to deliver ads to customers across Google sites and through the Google Network under our AdSense program.
- *Web sites*. We provide members of our Google Network our Google AdSense program, which allows these members to deliver AdWords ads that are relevant to the search results or content on their web sites. We share most of the fees these ads generate with our Google Network members—creating an important revenue stream for them.

How We Generate Revenue

We derive most of our revenues from fees we receive from our advertisers.

Our original business model consisted of licensing our search engine services to other web sites. In the first quarter of 2000, we introduced our first advertising program. Through our direct sales force we offered advertisers the ability to place text-based ads on our web sites targeted to our users' search queries under a program called Premium Sponsorships. Advertisers paid us based on the number of times their ads were displayed on users' search results pages, and we recognized revenue at the time these ads appeared. In the fourth quarter of 2000, we launched Google AdWords, an online self-service program that enables advertisers to place targeted text-based ads on our web sites. AdWords customers originally paid us based on the number of times their ads appeared on users' search results pages. In the first quarter of 2002, we began offering AdWords exclusively on a cost-per-click basis, which means that an advertiser pays us only when a user clicks on one of its ads. AdWords is also available through our direct sales force. Our AdWords agreements are generally terminable at any time by our advertisers. We recognize as revenue the fees charged advertisers each time a user clicks on one of the text-based ads that appears next to the search results on our web sites.

Effective January 1, 2004, we terminated the Premium Sponsorships program and now offer a single pricing structure to all of our advertisers based on the AdWords cost-per-click model. Our AdWords cost-per-click program is the advertising program through which we generate revenues by serving ads on our web sites and on Google Network member web sites through our AdSense program.

Google AdSense is the program through which we distribute our advertisers' AdWords ads for display on the web sites of our Google Network members. Our AdSense program includes AdSense for search and AdSense

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for content. AdSense for search, launched in the first quarter of 2002, is our service for distributing relevant ads from our advertisers for display with search results on our Google Network members' sites. AdSense for content, launched in the first quarter of 2003, is our service for distributing ads from our advertisers that are relevant to content on our Google Network members' sites. Our advertisers pay us a fee each time a user clicks on one of our advertisers' ads displayed on Google Network members' web sites. In the past, we have paid most of these advertiser fees to the members of the Google Network, and we expect to continue doing so for the foreseeable future. We recognize these advertiser fees as revenue and the portion of the advertiser fee we pay to our Google Network members as traffic acquisition costs under cost of revenue. In some cases, we guarantee our Google Network members minimum revenue share payments. Members of the Google Network do not pay any fees associated with the use of our AdSense program on their web sites. Some of our Google Network members separately license our web search technology and pay related licensing fees to us. Our agreements with Google Network members consist largely of uniform online "click-wrap" agreements that members enter into by interacting with our registration web sites. Agreements with our larger members are individually negotiated. The standard agreements have no stated term and are terminable at will. The negotiated agreements vary in duration. Both the standard agreements and the negotiated agreements contain provisions requiring us to share with the Google Network member a portion of the advertiser fees generated by users clicking on ads on the Google Network member's web site. The standard agreements have uniform revenue share terms. The non-standard agreements vary as to revenue share terms and are heavily negotiated.

We believe the factors that influence the success of our advertising programs include the following:

- The relevance, objectivity and quality of our search results.
- The number and type of searches initiated at our web sites.
- The number and type of searches initiated at, as well as the number of visits to and the content of, our Google Network members' web sites.
- The advertisers' return on investment (ad cost per sale or cost per conversion) from advertising campaigns on our web sites or our Google Network members' web sites compared to other forms of advertising.
- The number of advertisers and the diversity of items advertised.
- The total and per click advertising spending budgets of each advertiser.
- The monetization of (or generation of revenue from) traffic on our web sites and our Google Network members' web sites.

We believe that the monetization of traffic on our web sites and our Google Network members' web sites is affected by the following factors:

- The relevance and quality of ads displayed with each search results page on our web sites and our Google Network members' web sites, as well as with each content page on our Google Network members' web sites.
- The number and prominence of ads displayed with each search results page on our web sites and our Google Network members' web sites, as well as with each content page on our Google Network members' web sites.
- The total number of ads displayed on our web sites and on our Google Network members' web sites.
- The rate at which our users and users of our Google Network members' web sites click on advertisements.
- Our minimum fee per click, which is currently $0.05.

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Advertising revenues made up 94%, 97% and 99% of our revenues in 2002, 2003 and 2004. We derive the balance of our revenues from the license of our web search technology, the license of our search solutions to enterprises and the sale and license of other products and services.

Trends in Our Business

Our business has grown rapidly since inception, resulting in substantially increased revenues, and we expect that our business will continue to grow. However, although our revenue growth rate increased sequentially in the third and fourth quarters of 2004, our revenue growth rate has generally declined over time, and we expect it will continue to do so as a result of increasing competition and the inevitable decline in growth rates as our revenues increase to higher levels. Consequently, we believe that our sequential quarterly revenue growth rate in the fourth quarter of 2004 will not be sustainable in future periods. In addition, the main focus of our advertising programs is to provide relevant and useful advertising to our users, reflecting our commitment to constantly improve their overall web experience, and therefore steps we take to improve the relevance of the ads displayed on our web sites, such as removing ads that generate low click-through rates, could negatively affect our near-term advertising revenues.

Both seasonal fluctuations in Internet usage and traditional retail seasonality have affected, and are likely to continue to affect, our business. Internet usage generally slows during the summer months, and commercial queries typically increase significantly in the fourth calendar quarter of each year. These seasonal trends have caused and will likely continue to cause, fluctuations in our quarterly results, including fluctuations in sequential revenue growth rates. Prior to the second quarter of 2004, these seasonal trends may have been masked by the substantial quarter over quarter growth of Internet traffic focused on commercial transactions and ultimately by the substantial quarter over quarter growth in our revenues. Our seasonality is discussed below in Quarterly Results of Operations.

Our operating margin declined in 2004 compared to 2003 primarily as a result of a $201.0 million non-recurring charge taken in the third quarter of 2004 related to the settlement of disputes with Yahoo. Our operating margin before this charge was greater in 2004 compared to 2003 primarily as a result of a decrease in stock-based compensation as a percentage of revenues. We expect stock-based compensation as a percentage of revenues to decrease further in the first half of 2005 compared to the fourth quarter of 2004. However, we expect stock-based compensation as a percentage of revenues to increase in the second half of 2005, and in at least the near-term thereafter, compared to the first half of 2005, primarily as a result of our adoption of the new stock-based compensation accounting rules beginning in the third quarter of 2005, and our plan to grant substantially more restricted stock units in 2005 as compared to 2004. As a result, our operating margins will be negatively affected. For additional discussion regarding these new stock-based compensation accounting rules, see Effect of a Recent Accounting Pronouncement, included elsewhere in this Form 10-K.

The increase in our operating margin in 2004 compared to 2003 (before the charge related to the settlement of disputes with Yahoo) was partially offset by an increase in traffic acquisition costs as a percentage of revenues. This is because a greater portion of our revenues in 2004 compared to 2003 was from our Google Network members' web sites rather than from our Google web sites. The operating margin we realize on revenues generated from our AdSense program is significantly lower than that generated from our web sites. This lower operating margin arises because most of the advertiser fees from our AdSense agreements are shared with our Google Network members, leaving only a portion of these fees for us. From the inception of the Google Network in 2002 through the first quarter of 2004, the growth in advertising revenues from our Google Network members' web sites exceeded that from our web sites. This resulted in an increase in the portion of our revenue from our Google Network members' web sites compared to our own web sites and had a negative impact on operating margins. However, in the second, third and fourth quarters of 2004, growth in advertising revenues from our web sites exceeded that from our Google Network members' web sites. We expect that this will continue in the foreseeable future although the relative rate of growth in revenues from our web sites compared to the rate of growth in revenues from our Google Network members' web sites may vary over time.

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Our operating margin may experience downward pressure in the future as we build the necessary employee and systems infrastructures required to manage our anticipated growth. We expect that the growth rate of our costs and expenses (other than stock-based compensation for at least the first half of 2005) may exceed the growth rate of our revenues during 2005 and beyond. We have experienced and expect to continue to experience substantial growth in our operations as we seek to expand our user, advertiser and Google Network member bases and continue to expand our presence in international markets. This growth has required the continued expansion of our human resources and substantial investments in property and equipment. Our full-time employee headcount has grown from 1,628 at December 31, 2003 to 3,021 at December 31, 2004. Also, we have employed a significant number of temporary employees in the past and expect to continue to do so in the foreseeable future. Our capital expenditures have grown from $176.8 million in 2003 to $319.0 million in 2004. We expect to spend over $500 million on property and equipment, including information technology infrastructure, to manage our operations during 2005, however, we may spend less depending on the availability of suitable property and equipment. As a result, our spending between periods may fluctuate significantly. Management of this growth will continue to require the devotion of significant employee and other resources. We may not be able to manage this growth effectively.

The portion of our revenues derived from international markets has increased. Our international revenues have grown as a percentage of our total revenues from 22% in 2002 to 29% in 2003 to 34% in 2004. This increase in the portion of our revenues derived from international markets results largely from increased acceptance of our advertising programs, an increase in our direct sales resources and customer support operations and our continued progress in developing versions of our products tailored for these markets.

Our effective tax rate beginning in the first quarter of 2005, and for the foreseeable future thereafter, is expected to be significantly lower than our effective tax rate of 39% in 2004. This is primarily because proportionately more of our earnings in 2005 compared to 2004 are expected to be recognized by our Irish subsidiary, and such earnings are taxed at a lower statutory tax rate than in the U.S. However, if the proportion of our future earnings recognized by our Irish subsidiary is not at the level we expect, our effective tax rate may not decrease as significantly, if at all. In addition, our provision for income taxes will be significantly reduced in the first quarter of 2005 as a result of disqualifying dispositions that occurred during that period. However, for the foreseeable future thereafter, we do not expect further significant reductions to our provision for income taxes as a result of disqualifying dispositions that may occur after the first quarter of 2005 related to incentive stock options currently outstanding. Furthermore, we do not expect to grant a significant number of incentive stock options in the foreseeable future. For additional discussion regarding the accounting for disqualifying dispositions on incentive stock options, see Critical Accounting Policies and Estimates included elsewhere in this Form 10-K.

Results of Operations

The following is a more detailed discussion of our financial condition and results of operations for the periods presented.

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The following table presents our historical operating results as a percentage of revenues for the periods indicated:

	Year Ended December 31, 2002	Year Ended December 31, 2003	Year Ended December 31, 2004	Three Months Ended September 30, 2004 (unaudited)	Three Months Ended December 31, 2004 (unaudited)
Consolidated Statement of Income Data:					
Revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Costs and expenses:					
Cost of revenues	29.9	42.7	45.7	44.9	44.0
Research and development	7.2	6.2	7.1	7.1	8.5
Sales and marketing	10.0	8.2	7.7	8.1	7.4
General and administrative	5.5	3.9	4.4	5.1	5.0
Stock-based compensation	4.9	15.6	8.7	8.5	5.8
Non-recurring portion of settlement of disputes with Yahoo	—	—	6.3	24.9	—
Total costs and expenses	57.5	76.6	79.9	98.6	70.7
Income from operations	42.5	23.4	20.1	1.4	29.3
Interest income (expense) and other, net	(0.4)	0.2	0.3	0.5	0.7
Income before income taxes	42.1	23.6	20.4	1.9	30.0
Provision (benefit) for income taxes	19.4	16.4	7.9	(4.6)	10.2
Net income	22.7%	7.2%	12.5%	6.5%	19.8%

Revenues

The following table presents our revenues, by revenue source, for the periods presented:

	Year Ended December 31, 2002	Year Ended December 31, 2003	Year Ended December 31, 2004	Three Months Ended September 30, 2004	Three Months Ended December 31, 2004
			(in thousands)	(unaudited)	
Advertising Revenues					
Google web sites	$306,978	$ 792,063	$1,589,032	$ 411,671	$ 530,387
Google Network web sites	103,937	628,600	1,554,256	384,285	489,993
Total advertising revenues	410,915	1,420,663	3,143,288	795,956	1,020,380
Licensing and other revenues	28,593	45,271	45,935	9,931	11,121
Revenues	$439,508	$1,465,934	$3,189,223	$ 805,887	$1,031,501

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The following table presents our revenues, by revenue source, as a percentage of total revenues for the periods presented:

	Year Ended December 31,			Three Months Ended	
	2002	2003	2004	September 30, 2004	December 31, 2004
				(unaudited)	
Advertising Revenues					
Google web sites	70%	54%	50%	51%	51%
Google Network web sites	24	43	49	48	48
Total advertising revenues	94	97	99	99	99
Google web sites as % of advertising revenues	*75*	*56*	*51*	*52*	*52*
Google Network web sites as % of advertising revenues	*25*	*44*	*49*	*48*	*48*
Licensing and other revenues	6%	3%	1%	1%	1%

Growth in our revenues from 2003 to 2004 and from 2002 to 2003, resulted primarily from growth in revenues from ads on our Google Network members' web sites and growth in revenues from ads on our web sites. The advertising revenue growth resulted primarily from increases in the total number of paid clicks and ads displayed through our programs, rather than from changes in the average fees realized. The increase in the number of paid clicks was due to an increase in the number of Google Network members, an increase in aggregate traffic both on our web sites and those of our Google Network members and improvements in our ability to monetize increased traffic on our web sites.

Growth in our revenues from the three months ended September 30, 2004 to the three months ended December 31, 2004 resulted primarily from growth in revenues from ads on our web sites and growth in revenues from ads on our Google Network members' web sites. The advertising revenue growth resulted primarily from increases in the total number of paid clicks, rather than from changes in the average fees realized. Our revenues grew by 15.1% from the three month period ended June 30, 2004 to the three month period ended September 30, 2004, but grew by 28.0% from the three month period ended September 30, 2004 to the three month period ended December 31, 2004. The reasons for the increases in the sequential quarter revenue growth rates are described in the following paragraphs.

Growth in advertising revenues from our Google Network members' web sites from the three months ended September 30, 2004 to the three months ended December 31, 2004 was $105.7 million or 27.5%, compared to $38.1 million or 11.0% from the three months ended June 30, 2004 to the three months ended September 30, 2004. The increase in the growth rate is attributable to growth in the number of page views with ads, and ultimately paid clicks. This growth is primarily attributable to more aggregate ads displayed on the content and search results pages of our Google Network members' web sites, primarily as a result of the following factors:

- Our entering into more AdSense for content agreements over the third and fourth quarters compared to the second and third quarters of this year.
- Our Google Network members realizing more aggregate traffic at their web sites in the fourth quarter compared to the third quarter, substantially as a result of seasonality.
- Our entering into a significant AdSense for search agreement with AOL Europe in the fourth quarter of 2004.

Although the growth in advertising revenues from our Google Network members' web sites was nearly as great as that from our web sites from the three months ended September 30, 2004 compared to the three months ended December 31, 2004, we expect this growth to be slower than the growth in revenues from our web sites for the foreseeable future.

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Growth in advertising revenues from our web sites from the three months ended September 30, 2004 to the three months ended December 31, 2004 was $118.7 million or 28.8% compared to $68.2 million or 19.9% from the three months ended June 30, 2004 to the three months ended September 30, 2004. The increase in the growth rate for the fourth quarter of 2004 is primarily attributable to growth in the number of paid clicks which is a result of increased traffic, substantially due to seasonality, and improvements in our ability to monetize this increased traffic.

We believe that the increase in the number of paid clicks is the result of the relevance and quality of both the search results and advertisements displayed, which results in more searches, advertisers and Google Network members, and ultimately, more paid clicks. We expect that our revenue growth rates will generally decline in the future as a result of increasing competition and the inevitable decline in growth rates as our revenues increase to higher levels. Consequently, we believe that our sequential quarterly revenue growth rate in the fourth quarter of 2004 will not be sustainable in future periods.

Revenues by Geography

Domestic and international revenues as a percentage of consolidated revenues, determined based on the billing addresses of our advertisers, are set forth below.

	Year Ended December 31,			Three Months Ended	
	2002	2003	2004	September 30, 2004	December 31, 2004
				(unaudited)	
United States	78%	71%	66%	65%	65%
International	22%	29%	34%	35%	35%

The growth in international revenues is the result of our efforts to provide search results to international users and deliver more ads from non-U.S. advertisers. We expect that international revenues will continue to grow as a percentage of our total revenues in the future. While international revenues accounted for approximately 29% of our total revenues in 2003 and 34% in 2004, more than half of our user traffic came from outside the U.S. See Note 13 of Notes to Consolidated Financial Statements included as part of this Form 10-K for additional information about geographic areas.

Costs and Expenses

Cost of Revenues. Cost of revenues consists primarily of traffic acquisition costs. Traffic acquisition costs consist of amounts ultimately paid to our Google Network members. These amounts are primarily based on revenue share arrangements under which we pay our Google Network members most of the fees we receive from our advertisers whose ads we place on those Google Network member sites. In addition, certain AdSense agreements obligate us to make guaranteed minimum revenue share payments to Google Network members based on their achieving defined performance terms, such as number of search queries or advertisements displayed. We amortize guaranteed minimum revenue share prepayments (or accrete an amount payable to our Google Network member if the payment is due in arrears) based on the number of search queries or advertisements displayed on the Google Network member's web site. In addition, concurrent with the commencement of a small number of AdSense agreements, we have purchased certain items from, or provided other consideration to, our Google Network members. These amounts are amortized on a straight-line basis over the related term of the agreement.

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The following table presents our traffic acquisition costs (in millions), traffic acquisition costs as a percentage of advertising revenues from Google Network web sites and traffic acquisition costs as a percentage of advertising revenues, for the periods presented.

	Year Ended December 31,			Three Months Ended	
	2002	2003	2004	September 30, 2004	December 31, 2004
		(unaudited)		(unaudited)	
Traffic acquisition costs	$94.5	$526.5	$1,228.7	$ 302.9	$ 377.7
Traffic acquisition costs as a percentage of advertising revenues from Google Network web sites	91%	84%	79%	79%	77%
Traffic acquisition costs as a percentage of advertising revenues	23%	37%	39%	38%	37%

In addition, cost of revenues consists of the expenses associated with the operation of our data centers, including depreciation, labor, energy and bandwidth costs. Cost of revenues also includes credit card and other transaction fees related to processing customer transactions, as well as amortization of expenses related to purchased and licensed technologies.

Cost of revenues increased by $91.7 million to $453.8 million (or 44.0% of revenues) in the three months ended December 31, 2004, from $362.1 million (or 44.9% of revenues) in the three months ended September 30, 2004. This increase in dollars was primarily the result of additional traffic acquisition costs and the depreciation of additional information technology assets purchased in the current and prior periods and additional data center costs required to manage more Internet traffic, advertising transactions and new products and services. There was an increase in traffic acquisition costs of $74.8 million and an increase in data center costs of $7.6 million primarily resulting from the depreciation of additional information technology assets purchased in the current and prior periods.

Traffic acquisition costs decreased as a percentage of advertising revenues from Google Network web sites in the three months ended December 31, 2004 compared to the prior quarter primarily because more of these revenues came from members with whom we generally have lower revenue share obligations. Also, the aggregate dollar amount by which guaranteed revenue share and other payments to Google Network members exceeded the fees we received from advertisers under certain AdSense agreements was less in the three months ended December 31, 2004 compared to the three months ended September 30, 2004. Traffic acquisition costs also decreased as a percentage of advertising revenues in the three months ended December 31, 2004, primarily because of the reasons noted above and because a slightly smaller proportion of advertising revenues came from ads on our Google Network members' web sites compared to our web sites.

Cost of revenues increased by $831.8 million to $1,457.7 million (or 45.7% of revenues) in 2004, from $625.9 million (or 42.7% of revenues) in 2003. The increase in dollars was primarily the result of an increase in traffic acquisition costs of $702.1 million, as well as an increase in data center costs of $88.7 million primarily resulting from the depreciation of additional information technology assets purchased in the current and prior periods and other data center costs required to manage more Internet traffic, advertising transactions and new products and services. In addition, there was an increase in credit card and other transaction processing fees of $26.0 million resulting from more advertiser fees generated through AdWords. The increase in cost of revenues as a percentage of revenues, as well as traffic acquisition costs as a percentage of advertising revenues, was primarily the result of proportionately greater revenues from our Google Network members' web sites compared to our web sites.

Cost of revenues increased by $494.4 million to $625.9 million (or 42.7% of revenues) in 2003, from $131.5 million (or 29.9% of revenues) in 2002. This increase was primarily the result of increased traffic acquisition costs and additional data center costs required to manage more Internet traffic, advertising transactions and new products and services. Traffic acquisition costs increased $432.0 million due to an increase

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in the number of paid clicks on our Google Network members' web sites. There was an increase in data center costs of $39.9 million primarily resulting from depreciation of additional information technology assets purchased in current and prior periods. In addition, there was an increase of $15.7 million in credit card and other transaction processing fees and an increase of $4.9 million related to amortization of developed technology resulting from acquisitions in 2003.

We expect cost of revenues to continue to increase in dollars in 2005 compared to 2004, primarily as a result of forecasted increases in traffic acquisition costs, and in our data center costs required to manage increased traffic, advertising transactions and new products and services. Traffic acquisition costs as a percentage of advertising revenues are expected to decrease because we believe revenue growth from our Google Network members' web sites will be less than that from our web sites for the foreseeable future. In addition, traffic acquisition costs as a percentage of advertising revenues will experience downward pressure in the future to the extent we enter into proportionately more AdSense arrangements with members to whom we generally have lower revenue share obligations. However, this trend may be offset in the future to the extent competition for arrangements with web sites that are existing and potential Google Network members increases, which would likely result in less favorable revenue share arrangements.

Research and Development. Research and development expenses consist primarily of compensation and related costs for personnel responsible for the research and development of new products and services, as well as significant improvements to existing products and services. We expense research and development costs as they are incurred.

Research and development expenses increased by $30.0 million to $87.4 million (or 8.5% of revenues) in the three months ended December 31, 2004, from $57.4 million (or 7.1% of revenues) in the three months ended September 30, 2004. This increase was primarily due to an increase in labor and facilities related costs of $15.3 million, primarily as a result of a 16% and 42% increase in research and development headcount from September 30, 2004 and June 30, 2004 to December 31, 2004. In addition, depreciation and related expenses increased by $3.3 million primarily as a result of additional information technology assets purchased over the six months ended December 31, 2004. We also recognized $10.4 million of in-process research and development expenses as a result of acquisitions in the three months ended December 31, 2004 and none in the three months ended September 30, 2004. Note 4 of Notes to Consolidated Financial Statements included as part of this Form 10-K describes further purchased in-process research and development expenses and other acquisitions.

Research and development expenses increased by $134.4 million to $225.6 million (or 7.1% of revenues) in 2004, from $91.2 million (or 6.2% of revenues) in 2003. This increase was primarily due to an increase in labor and facilities related costs of $98.7 million as a result of a 106% increase in research and development headcount. In addition, depreciation and related expenses increased by $28.2 million primarily as a result of increasing dollar amounts of information technology assets purchased during 2003 and 2004.

Research and development expenses increased by $59.5 million to $91.2 million (or 6.2% of revenues) in 2003, from $31.7 million (or 7.2% of revenues) in 2002. This increase in dollars was primarily due to an increase in labor and facilities related costs of $34.3 million as a result of a 101% increase in research and development headcount. In addition, we recognized $11.6 million of in-process research and development expenses during 2003 as a result of an acquisition.

We anticipate that research and development expenses will continue to increase in dollar amount and may increase as a percentage of revenues in 2005 and future periods because we expect to hire more research and development personnel and build the infrastructure required to support the development of new, and improve existing, products and services.

Sales and Marketing. Sales and marketing expenses consist primarily of compensation and related costs for personnel engaged in customer service and sales and sales support functions, as well as advertising and promotional expenditures.

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Sales and marketing expenses increased $10.6 million to $76.1 million (or 7.4% of revenues) in the three months ended December 31, 2004, from $65.5 million (or 8.1% of revenues) in the three months ended September 30, 2004. This increase in dollars was primarily due to an increase in labor and facilities related costs of $10.9 million mostly as a result of an 11% and 28% increase in sales and marketing headcount from September 30, 2004 and June 30, 2004 to December 31, 2004, partially offset by a decrease in promotional expenditures. The increase in sales and marketing personnel was a result of our on-going efforts to secure new, and to provide support to our existing users, advertisers and Google Network members, on a worldwide basis.

Sales and marketing expenses increased $126.0 million to $246.3 million (or 7.7% of revenues) in 2004, from $120.3 million (or 8.2% of revenues) in 2003. This increase in dollars was primarily due to an increase in labor and facilities related costs of $91.8 million mostly as a result of a 74% increase in sales and marketing headcount. In addition, advertising and promotional expenses increased $17.3 million and travel-related expenses increased $3.3 million. The increase in sales and marketing personnel and advertising, promotional and travel-related expenses was a result of our on-going efforts to secure new, and to provide support to our existing, users, advertisers and Google Network members, on a worldwide basis. For instance, we have hired personnel to help our advertisers maximize their return on investment through the selection of appropriate keywords and have promoted the distribution of the Google Toolbar to Internet users in order to make our search services easier to access.

Sales and marketing expenses increased $76.5 million to $120.3 million (or 8.2% of revenues) in 2003, from $43.8 million (or 10.0% of revenues) in 2002. This increase in dollars was primarily due to an increase in labor and facilities related costs of $54.4 million mostly as a result of a 149% increase in sales and marketing headcount. In addition, advertising and promotional expenses increased $12.9 million and travel related expenses increased $3.2 million, primarily in the second half of 2003.

We anticipate sales and marketing expenses will continue to increase in dollar amount and may increase as a percentage of revenues in 2005 and future periods as we continue to expand our business on a worldwide basis. A significant portion of these increases relate to our plan to add support personnel to increase the level of service we provide to our advertisers and Google Network members. We also plan to add a significant number of international sales personnel and increase promotional and advertising expenditures to support our worldwide expansion.

General and Administrative. General and administrative expenses consist primarily of compensation and related costs for personnel and facilities related to our finance, human resources, facilities, information technology and legal organizations, and fees for professional services. Professional services are principally comprised of outside legal, audit and information technology consulting. To date, we have not experienced any significant amount of bad debts.

General and administrative expenses increased $11.1 million to $51.8 million (or 5.0% of revenues) in the three months ended December 31, 2004, from $40.8 million (or 5.1% of revenues) in the three months ended September 30, 2004. This increase was primarily due to an increase in labor and facilities related costs of $6.6 million, primarily as a result of a 15% and 24% increase in headcount from September 30, 2004 and June 30, 2004 to December 31, 2004, and an increase in professional services fees of $4.4 million. The additional personnel and professional services fees are primarily the result of our on-going efforts to build the legal, finance, human resources, recruiting and information technology functions required of a growing public company.

General and administrative expenses increased $83.0 million to $139.7 million (or 4.4% of revenues) in 2004, from $56.7 million (or 3.9% of revenues) in 2003. This increase in dollars was primarily due to an increase in labor and facilities related costs of $43.1 million, primarily as a result of an 85% increase in headcount, an increase in professional services fees of $25.4 million, an increase in depreciation and related expenses of $7.9 million and an increase in the amortization of intangibles of $4.7 million. The additional personnel, professional services fees and depreciation and related expenses are the result of the growth of our business.

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General and administrative expenses increased $32.4 million to $56.7 million (or 3.9% of revenues) in 2003, from $24.3 million (or 5.5% of revenues) in 2002. This increase in dollars was primarily due to an increase in labor and facilities related costs of $16.7 million, primarily as a result of a 194% increase in headcount, and an increase in professional services fees of $10.0 million, primarily in the second half of 2003.

As we expand our business and incur additional expenses associated with being a public company, we believe general and administrative expenses will continue to increase in dollar amount and may increase as a percentage of revenues in 2005 and in future periods. In addition, contributions we make to charitable and other organizations are expected to increase in dollar amount and as a percentage of revenues in 2005 compared to 2004.

Stock-Based Compensation. Prior to the date of our initial public offering, we typically granted stock options at exercise prices equal to or less than the value of the underlying stock as determined by our board of directors on the date of option grant. For purposes of financial accounting, we have applied hindsight within each year or quarter prior to our initial public offering to arrive at reassessed values for the shares underlying these options. We recorded the difference between the exercise price of an option awarded to an employee and the reassessed value of the underlying shares on the date of grant as deferred stock-based compensation. The determination of the reassessed value of stock underlying options is discussed in detail below in Critical Accounting Policies and Estimates—Stock-Based Compensation, included elsewhere in this Form 10-K. We recognize compensation expense as we amortize the deferred stock-based compensation amounts on an accelerated basis over the related vesting periods, generally four or five years. After the initial public offering, options have been generally granted at exercise prices equal to the fair market value of the underlying stock on the date of option grant and, accordingly, little or no related stock-based compensation will be recognized under the current accounting rules. Also, in the fourth quarter of 2004, we granted restricted stock units to certain employees. In addition, in the past we have awarded options to non-employees to purchase our common stock. Stock-based compensation related to non-employees is measured on a fair-value basis using the Black-Scholes valuation model as the options are earned.

Stock-based compensation decreased $8.5 million to $59.5 million (or 5.8% of revenues) in the three months ended December 31, 2004 from $68.0 million (or 8.5% of revenues) in the three months ended September 30, 2004. The decrease in dollars was due to less amortization of deferred stock-based compensation amounts from prior periods recognized in the three months ended December 31, 2004 compared to the three months ended September 30, 2004. This decrease was primarily due to options that we granted after the initial public offering at exercise prices generally equal to the fair market value of the underlying stock on the date of grant. As a result, these options were granted with little or no intrinsic value and, accordingly, no related stock-based compensation will be recognized under the current accounting rules. In addition, we granted fewer options and with less aggregate intrinsic value in 2004 prior to the initial public offering compared to 2003. This decrease in dollars was partially offset by $1.7 million of stock-based compensation that we recognized in the three months ended December 31, 2004 related to $12.0 million of restricted stock units granted in that quarter. These restricted stock units will be recognized as stock-based compensation on an accelerated basis over the related vesting period of four years.

Stock-based compensation increased $49.3 million to $278.7 million (or 8.7% of revenues) in 2004 from $229.4 million (or 15.6% of revenues) in 2003. The increase in dollars was primarily driven by the generally larger differences between the exercise prices and the reassessed values of the underlying common stock on the dates of grant, partially offset by a decrease in the level of stock option grants, in recent periods prior to our initial public offering. This increase was also partially offset by a decrease of $6.9 million to $3.9 million of stock-based compensation recognized in 2004 related to the modification of terms of former employees' stock option agreements.

Stock-based compensation increased $207.8 million to $229.4 million (or 15.6% of revenues) in 2003 from $21.6 million (or 4.9% of revenues) in 2002. The increase was primarily driven by the larger differences between

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the exercise prices and the reassessed values of the underlying common stock on the dates of grant and, to a lesser extent, an increase in the level of stock option grants in 2003.

We expect stock-based compensation to be $145.8 million in 2005, $70.5 million in 2006, $25.9 million in 2007, $5.6 million in 2008, $1.3 million in 2009 and $0.4 million thereafter, related to deferred stock-based compensation on our balance sheet at December 31, 2004. These amounts do not include stock-based compensation related to:

- restricted stock or restricted stock units that may or will be granted to employees subsequent to December 31, 2004 (we expect restricted stock units of significantly greater dollar value on the date of grant to be issued to our employees in 2005 and future periods compared to the $12.0 of restricted stock units issued in 2004).
- the effect of changes to the stock-based accounting rules as set forth under Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, which we will adopt beginning July 1, 2005 (for additional discussion regarding the expected effect of this pronouncement, see Effect of a Recent Accounting Pronouncement included elsewhere in this Form 10-K).
- options granted to non-employees.
- options that may be granted to employees and directors subsequent to December 31, 2004 at exercise prices less than the fair market value on the date of grant. These amounts also assume the continued employment throughout the referenced periods of the recipient of the options that gave rise to the deferred stock-based compensation.

At December 31, 2004, there were 302,950 unvested options held by nonemployees with a weighted-average exercise price of $0.52 and a weighted-average 36 months remaining vesting period. These options generally vest on a monthly and ratable basis. Depending on the fair market value of these options on their vesting dates, the related charge could be significant during 2005 and subsequent periods. We recognized $15.0 million of stock-based compensation related to these options that vest over time in 2004. No options that vest over time were granted to non-employees in 2004.

See Note 1 of Notes to Consolidated Financial Statements, as well as Critical Accounting Policies and Estimates and Effect of a Recent Accounting Pronouncement, included elsewhere in this Form 10-K for additional information about stock-based compensation.

Non-recurring Portion of Settlement of Disputes with Yahoo

On August 9, 2004, we and Yahoo entered into a settlement agreement resolving two disputes that had been pending between us. The first dispute concerned a lawsuit filed by Yahoo's wholly-owned subsidiary, Overture Services, Inc., against us in April 2002 asserting that certain services infringed Overture's U.S. Patent No. 6,269,361. In our court filings, we denied that we infringed the patent and alleged that the patent was invalid and unenforceable.

The second dispute concerned a warrant held by Yahoo to purchase 3,719,056 shares of our stock in connection with a June 2000 services agreement. Pursuant to a conversion provision in the warrant, in June 2003 we issued 1,229,944 shares to Yahoo. Yahoo contended it was entitled to a greater number of shares, while we contended that we had fully complied with the terms of the warrant.

As part of the settlement, Overture dismissed its patent lawsuit against us and has granted us a fully-paid, perpetual license to the patent that was the subject of the lawsuit and several related patent applications held by Overture. The parties also mutually released any claims against each other concerning the warrant dispute. In connection with the settlement of these two disputes, we issued to Yahoo 2,700,000 shares of Class A common stock.

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We incurred a non-recurring non-cash charge of $201.0 million in the third quarter of 2004 related to this settlement. The non-cash charge included among other items, the value of shares associated with the settlement of the warrant dispute. See Note 5 of Notes to Consolidated Financial Statements included in this Form 10-K for additional information about the settlement of disputes with Yahoo.

Interest Income (Expense) and Other, Net

Interest income (expense) and other of $7.4 million in the three months ended December 31, 2004 was primarily the result of $9.2 million of interest income earned on our significant larger cash, cash equivalents and marketable securities balances. In addition, we recognized $1.9 million of other income, related to grants received from a foreign jurisdiction as a result of us creating new employment in that country. These income sources were partially offset by approximately $3.3 million of net foreign exchange losses that resulted from (i) the forward contracts that we entered into to purchase U.S. dollars with Euros to offset the foreign exchange risk on certain intercompany assets and (ii) the net monetary assets denominated in currencies other than the local currencies. These income sources were also offset by approximately $200,000 of realized losses on sales of marketable securities and approximately $200,000 of interest expense incurred on equipment leases, including the amortization of the fair value of warrants issued to lenders in prior years.

Interest income (expense) and other of $10.0 million in 2004 was primarily the result of approximately $16.0 million of interest income earned on our significantly larger average cash, cash equivalents and marketable securities balances and $1.9 million of other income, related to grants received from a foreign jurisdiction as a result of us creating new employment in that country. These income sources were partially offset by approximately $6.7 million of net foreign exchange losses that resulted from (i) the forward contracts that we entered into to purchase U.S. dollars with Euros to offset the foreign exchange risk on certain intercompany assets and (ii) the net monetary assets denominated in currencies other than the local currencies. These income sources were also offset by approximately $300,000 of realized losses on sales of marketable securities and approximately $900,000 of interest expense incurred on equipment loans and leases, including the amortization of the fair value of warrants issued to lenders in prior years.

Interest income (expense) and other of $4.2 million in 2003 was primarily the result of $2.7 million of interest income earned on cash, cash equivalents and marketable securities balances, and $2.1 million of net foreign exchange gains from net receivables denominated in currencies other than U.S. dollars as a result of generally strengthening foreign currencies against the U.S. dollar throughout 2003. In addition, we recognized $1.4 million of other income in 2003, primarily related to a gain recorded for certain upfront fees paid by advertisers whose ads were not delivered during the related contract periods. These income sources were partially offset by $1.9 million of interest expense incurred on equipment loans and leases, including the amortization of the fair value of warrants issued to lenders in prior years.

Provision for Income Taxes

Our provision for income taxes increased to $251.1 million in 2004 from $241.0 million in 2003. However, our effective tax rate, or our provision for income taxes as a percentage of our income before income taxes, decreased to 39% in 2004 from 70% in 2003. This decrease is primarily a result of reductions to our provision for income taxes after our initial public offering in August 2004 related to certain stock-based compensation and disqualifying dispositions on incentive stock options. After our initial public offering and through the end of the year, we reduced our provision for income taxes by $23.0 million and $70.0 million as a result of stock-based compensation recognized during and prior to this period related to unexercised non-qualified stock options. In addition, we reduced our provision for income taxes by $42.2 million as a result of disqualifying dispositions that occurred after our initial public offering related to cumulative stock-based compensation recognized for all of our incentive stock options. No reductions were made to our provision for income taxes in 2003 related to stock-based compensation. Without these reductions in 2004, our provision for income taxes would have been increased by approximately $135.2 million, which would have increased our effective tax rate by 20%. The